

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



October 20, 2004

Agenda ID #3986

TO: PARTIES OF RECORD IN RULEMAKING 93-04-003 ET AL.

This is the draft decision of Administrative Law Judge (ALJ) Reed. It will not appear on the Commission's agenda for at least 30 days after the date it is mailed. The Commission may act then, or it may postpone action until later.

When the Commission acts on the draft decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the draft decision as provided in Article 19 of the Commission's Rules of Practice and Procedure (Rules). These rules are accessible on the Commission's Website at <http://www.cpuc.ca.gov>. Pursuant to Rule 77.3 opening comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the Assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

/s/ ANGELA K. MINKIN
Angela K. Minkin, Chief
Administrative Law Judge

ANG:hkr

Attachment

Decision **DRAFT DECISION OF ALJ REED** (Mailed 10/20/2004)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks.

Rulemaking 93-04-003
(Filed April 7, 1993)

Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks.

Investigation 93-04-002
(Filed April 7, 1993)

Order Instituting Rulemaking on the Commission's Own Motion Into Competition for Local Exchange Service.

Rulemaking 95-04-043
(Filed April 26, 1995)

Order Instituting Investigation on the Commission's Own Motion Into Competition for Local Exchange Service.

Investigation 95-04-044
(Filed April 26, 1995)

**OPINION GRANTING PACIFIC BELL TELEPHONE COMPANY'S PETITION
TO MODIFY DECISION 02-09-050**

Summary

This order grants the March 9, 2004 Petition of Pacific Bell Telephone Company, doing business as SBC California, to modify Decision (D.) 02-09-050 (the *271 Decision*) by suspending the performance incentives plan doubling mechanism, set forth in Ordering Paragraphs (OPs) 10-14 of the *271 Decision*, until such time as the review of the performance incentives plan can be resumed

and completed. Until the review resumes and is completed, we direct SBC California to continue to track and record the data for any continuing extended chronic failures so that Staff can closely monitor the company's performance to ensure that no backsliding occurs. If the data tracked and recorded after the suspension of the doubling mechanism demonstrates backsliding by SBC California, the Commission shall reinstitute the doubling mechanism either upon its own motion or that of the interested parties. Should the doubling mechanism be revived as a result of a showing of discrimination by SBC California or of any competitive harm to the competitive local exchange carriers (CLECs), SBC California may file an application seeking reevaluation of the mechanism no sooner than 90 days after its reinstitution.

Background

In March 2002, this Commission approved a performance incentives plan requiring SBC California to credit CLECs with “incentive payments” whenever SBC California fails to meet certain wholesale obligations to the CLECs. (D.02-03-023 at 79.) The Commission-approved plan is a comprehensive service-quality assessment tool, based on numerous wholesale performance metrics developed in collaboration with the CLECs.

These metrics evaluate various aspects of wholesale service, including pre-ordering, ordering, provisioning, maintenance and repair, billing, and collocation. SBC California reports on nearly 6,000 performance results monthly. Many of these results are reported individually (i.e., for individual CLECs), while others are reported on an aggregate basis, depending on the terms of the plan. For functions SBC California provides for its own retail operations (or its affiliates’ operations), the performance results are measured against a standard of parity, with few exceptions. As a result, these measures evaluate whether SBC

California provides CLECs service in "substantially the same time and manner" it provides service to itself.

The Commission has developed and approved a multifaceted set of statistical rules to determine whether SBC California is providing parity service to the CLECs for these measures. For those functions with no retail comparison, SBC California's performance is measured against a fixed benchmark. SBC California reports the performance metric results to the CLECs on a monthly basis. This Commission and the Federal Communications Commission (FCC) relied upon these results in evaluating SBC California's Section 271 long-distance application and determined that the Operations Support System (OSS) access that SBC California was providing to the CLECs was non-discriminatory.

Significantly, the incentive payments were also an integral part of SBC California's long distance application. In Section 271 applications filed prior to SBC California's long distance request, the FCC determined that Regional Bell Operating Companies (RBOCs) could satisfy the Section 271 public interest requirement by demonstrating they had agreed to self-executing remedy payments for failure to meet their wholesale obligations. According to the FCC, such a self-executing remedy plan would help prevent RBOCs from "backsliding" on their Section 271 wholesale obligations after obtaining long-distance approval.

To address the FCC's concerns regarding backsliding, the Commission established, in D.02-03-023, a comprehensive set of rules for assessing self-executing incentive payments against SBC California whenever the company misses any wholesale performance metrics. Under the rules, SBC California credits CLECs a certain amount of money for each parity or benchmark measure that SBC California misses. The amount paid varies according to how well SBC

California is performing on the overall set of measures and how often each particular measure has been missed. More particularly, the higher the percentage of overall measures missed by SBC California, the higher the amount credited for each missed measure. In addition, if a specific measure has been missed three consecutive months, the credits increase significantly for that measure. If a specific measure has been missed five out of the past six months, the credits increase substantially again.¹

In September 2002, the Commission adjusted the performance incentives plan in the *271 Decision* to address competitors' concerns that under the structure set forth in D.02-03-023, SBC California could ignore performance on certain measures and regard the associated incentive amounts as the "cost of doing business." By adding a doubling mechanism, the Commission sought to keep overall performance high and to discourage the selective treatment of sub-measures. Moreover, the Commission anticipated that SBC California and the other parties would be imminently discussing the doubling mechanism and other integral components of the incentive plan during the plan's projected six-month review. The six-month review, although initiated, has not been conducted and completed because competing priorities have occupied the Commission's assigned Staff. Thus, the doubling mechanism has been in effect for over two years.

¹ Under the formula, the assessment for a three-month failure is the credit of a one-month failure, plus five times that amount. The assessment for a five-out-of-six month failure is the credit of the one-month failure, plus a three-month failure, plus 10 times the one-month failure. See D.02-09-050, Ordering Paragraphs 10-14.

SBC California asks the Commission to modify the plan and suspend the doubling mechanism until the incentive plan review can be conducted and completed. The California Telecommunications Coalition² (Coalition) urges the Commission to deny the petition.

Position of the Parties

SBC California asserts that the plan's doubling mechanism has caused it to incur substantial performance incentive payments without any "new evidence" that the continued failures for which it is being assessed represent "increasingly accurate assessments" of discrimination or that competitive local exchange carriers are suffering any "competitive harm." SBC California also states that performance data gathered over the last year, and included with its petition, demonstrate that some measures reached the "continuing extended chronic" state not because SBC California failed to "fix" its processors or because it treated the misses as a "cost of doing business," but because certain events were largely or entirely beyond SBC California's control. (SBC California Petition at 7.)

SBC California illustrated this with examples of the performance results, calculated during the trial months, of 13 sub-measures.³ The company maintains

² For purposes of this filing, the Coalition includes Anew Telecommunications Corp. d.b.a. Call America, AT&T Communications of California, Inc., California Association of Competitive Telecommunications Companies (CALTEL), DMR Communications, New Edge Network, Inc. d.b.a. New Edge Networks, Pac-West Telecomm, Inc., Tri M Communications, Inc. d.b.a. TMC Communications, MCI, Inc. (formerly, WorldCom, Inc.), and XO California, Inc.

³ The affected sub-measures were: 1-04601, 1-04901, 1-06005 (Average Response Time to Pre-order Queries: Requests for TN (Verigate); Service Appointment Scheduling (Verigate); and Service Appointment Scheduling (EDI CORBA), respectively), 1-05600 and 1-06007 (Average Response Time to Pre-order Queries: Mechanized Loop Qualification—Actual—Verigate and EDI/CORBA respectively); 7-04701, 7-10601,

Footnote continued on next page

that these results show strings of failures and subsequent incentive payments caused by circumstances outside of its control. In several instances, the repeated failures triggered the doubling mechanism. In the remainder, SBC California contends that although the doubling mechanism was not triggered, the company made substantial payments absent any evidence of discrimination or competitive harm. SBC California states that it was able to stop the escalating payments only by negotiating redefinitions of the 13 sub-measures with the competitors, and submitting those redefinitions to the Commission for approval. Consequently, SBC California states that it “has no efficient or effective way to cope with the doubling feature when failures derive from circumstances beyond its control.” (*Id.* at 13.)

In January 2003, 23% of the incentive payments were attributable to the doubling mechanism. Today, that percentage has grown to over 71% of the overall incentive payments. At the same time, the number of continuing extended chronics has dropped from a high of 40 sub-measures in May 2003 to only 24 sub-measures in January 2004, out of the approximately 6,000 results

7-16501, 7-22401 (Average Completed Interval: UNE Loop 2/4 wire analog 8db and 5.5db—Bay, North, L.A., and South respectively); 19-93600, 20-97201 and 21-97401 (Customer Trouble Report Rate: UNE Platform-Basic port and 8db and 5.5db loop; Percentage of Customer Trouble Not Resolved Within Estimated Time; UNE Platform-Basic port and 8db and 5.5db loop; and Average Time to Restore: UNE Platform-Basic port and 8db and 5.5db loop); 19-93900 (Customer Trouble Report Rate: NXX Code Openings). Joint Declaration of Terry C. Gleason and Gwen S. Johnson In Support of SBC California’s Petition to Modify Decision 02-09-050 By Suspending Doubling Mechanism in Performance Incentives Plan (March 9, 2004).

reported monthly by SBC California.⁴ (*Id.*) SBC California insists that the incentive payments will soon escalate into the millions-of-dollars per month range, as a result of only a fraction (24 out of 6000) of the sub-measures being "out of compliance."

SBC California urges the Commission to suspend the doubling mechanism until it can complete the review of the incentive plan, and address concerns about the overall fairness of the mechanism and the soundness of the underlying assumptions. Suspension, it insists, will not pose any serious threat to competition while it has a significant financial impact resulting from events beyond the company's control.

In response, the Coalition urges that the Commission deny the Petition. It argues that as "part of a comprehensive performance plan established in Decision 02-03-023," the doubling mechanism "is working just as the Commission envisioned." (Coalition Response at 2.) As presently structured, the plan provides SBC California with the threat of potential liability at a level that is meaningful and acts as a significant incentive to comply with designated performance standards. The Coalition also maintains that the doubling mechanism gives SBC California the incentive to monitor its performance more closely, identify failures, and determine root causes quickly. It asserts that seeking modification of the Joint Partial Settlement Agreement (JPSA) is the best way to address those failures that are caused by poorly defined performance sub-measures.

⁴ Twenty-four of the 6,000 measures reported in January 2004 -- or only 0.4% of all the results -- generated doubling premiums \$678,128 out of the overall incentive payments of \$952,624, or 71% of total. (*Id.* at 12.)

The Coalition contends that SBC California has not justified its request to suspend the doubling mechanism, and the data submitted does not prove that the mechanism is either unfair or unjust. The incentive amounts that SBC California points to as having a “severe financial impact,” more accurately have been “de minimis (especially those to be paid to the smaller CLECs) relative to SBC’s overall scale and scope.” (*Id.* at 9.) The Coalition states that the Commission has provided the company with safeguards against ever incurring penalties that would impose severe financial harm by establishing limits, or caps, to the credits that SBC California must pay for performance failures.

The plan includes annual and monthly caps,⁵ and grants a formal review to SBC California before requiring any incentive payments above \$16.4 million per month. The Commission found these caps and other safeguards consistent with the percentage of net return liability that the FCC has approved in several other states’ performance incentive plans. (*Id.*) The Coalition also argues that because the doubling mechanism is an integral part of the incentive plan, the Commission should not suspend it without reviewing the entire plan. Finally, the Coalition urges summary denial of the Petition on the grounds that it is procedurally deficient: SBC California filed the request more than a year after the effective date of D.02-09-050 in violation of Rule 47(d) of the Commission’s Rules of Practice and Procedure (Rules).

In reply, SBC California notes that filing its Petition within one year of the *271 Decision* was impracticable. The doubling mechanism did not become

⁵ The overall annual cap was set at approximately \$601 million or 36% of the company's net return from local exchange servicing California. The monthly cap is set at 1/12 of the annual cap, or about \$50 million.

effective until January 2003. Thereafter, it took several months for SBC California to gather sufficient data to analyze and determine whether the doubling mechanism was working as intended. The company presented the case for modification once it accumulated evidence explaining the reasons for various failures and showing the lack of relationship to penalty amounts. In fact, much of the real harm occurred in the last few months where, because of the doubling mechanism's "multiplier effect," payments escalated by multiples of 8, 16 or 32 times the original amount. (SBC California Reply at 7.)

At the same time, SBC California was substantiating its concerns about the doubling mechanism, it was also participating in the preliminary work and discussions with Commission Staff on the expected incentive plan review. SBC California argues that its Petition should not be denied on procedural grounds because it delayed filing its request out of the belief that the review would take place in late 2003 or early 2004, where it would have had the opportunity to further examine the doubling mechanism. (*Id.*)

SBC California points out that the Coalition presents no evidence of discrimination on SBC California's part or of any competitive harm suffered by the CLECs. It advises that the Commission could quickly reinstate the doubling mechanism if evidence of backsliding should occur after suspension. SBC California also asserts that the competitors know, and have stated to the Commission in other proceedings, that amending the JPSA is a cumbersome and time-consuming process. Therefore, using the process to stem the losses attributable to the doubling mechanism would be inefficient and futile in some instances. SBC California denies the Coalition's contention that the escalating incentive payments are "de minimis," and contends that the payments for the continuing failures bear no rational relationship to SBC California's conduct or

any competitive harm suffered by the CLECs. As such, the payments are becoming penalties or fines in violation of California law. (*Id.*)

Discussion

In September 2002, the Commission looked forward to the review of the performance incentive plan as the most appropriate forum to study the plan's real world data and impact. We targeted the reexamination for six months in order to resolve as soon as possible several outstanding issues from D.02-03-023 and also to take advantage of the momentum generated by the proceeding. This momentum was the result of the collaborative process in which Staff and the parties participated with the Commission to create the plan. In adding the doubling mechanism to the plan in the *271 Decision*, we intended to look closely at the effects and concerns with the underlying assumptions of the mechanism in the expected review. While Staff and the parties began some preliminary work in 2003 towards the review, other pressing Commission priorities have delayed its progress and completion.

In response to SBC California's Petition, the Coalition overstates the contention that the doubling mechanism has had its intended effect. The Commission's intent was not to completely sever the connection between the harm imposed and the rigor of the performance incentive. In fact, we noted in the *271 Decision* that “[d]uring the first review we may discover a better way to accomplish this balance between erroneously treating good performances as bad or bad performances as good.” (D.02-09-050 at 244.) Moreover, the Coalition does not refute with either facts or data SBC California's substantiation of the costly impact of the doubling mechanism, particularly on performance failures outside of the company's control.

The Coalition argues that promptly amending the JPSA is a more appropriate remedy than suspending the doubling mechanism to address SBC California's increasing incentive payments. At the same time, it has also pointed to the leaden pace of the JPSA review and amendment process in January 2004 comments⁶ in the Triennial Review Order proceeding, and in March 2004, several CLECs moved⁷ to defer commencement of the 2004 JPSA Review. Nevertheless, it appears from the unrefuted data presented in SBC California's pleadings that JPSA changes do not always correct the burdens and flaws of the doubling mechanism.

Finally, we find no merit in the assertion that SBC California's Petition is procedurally defective. In September 2003, a year after the issuance of the *271 Decision*, SBC California would not have had time to record and analyze sufficient months of data reflecting the impact of the doubling mechanism given the mechanism's January 2003 effective date. By submitting its petition and joint declaration in March 2004, SBC California submitted a more comprehensive analysis of its performance results than it would have been able to if it had filed six months earlier in September 2003.

While we intend to recommence and complete the Performance Incentive Review, we are not persuaded that the Commission must wait until it has reexamined all the components of the plan before it addresses the effect of the

⁶ Comments of AT&T Communications California, Inc. and MCI on Issue Concerning Performance Measurements for the Batch Hot Cut Process Triennial Review Order Nine Month Phase (January 23, 2004).

⁷ Motion to Defer Commencement of 2004 Review of OSS Performance Measurements (March 4, 2004).

doubling mechanism. We find that the doubling mechanism, as currently structured, imposes a significant financial impact on SBC California without a showing of related performance discrimination against, or competitive harm to any CLEC. Thus, we shall grant SBC California's petition to modify D.02-09-050.

Consequently, we shall suspend the doubling mechanism in the Performance Incentive Plan until the six-month review of the plan can be completed. Until the review resumes and is completed, we direct SBC California to continue to track and record the data for any continuing extended chronic failures so that Staff can closely monitor the company's performance to ensure that there is no backsliding. If the data demonstrates backsliding, the Commission will reinstitute the doubling mechanism either upon its own motion or that of the interested parties. Should the doubling mechanism be revived as a result of a showing of discrimination by SBC California, or of any competitive harm to the CLECs, SBC California may file an application with the Commission seeking reevaluation of the mechanism no sooner than 90 days after its reinstitution.

Comments on Draft Decision

The draft decision of the Administrative Law Judge (ALJ) in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7. Comments were filed on _____, and reply comments were filed on_____.

Assignment of Proceeding

Geoffrey F. Brown is the Assigned Commissioner and Jacqueline A. Reed is the assigned ALJ in this proceeding.

Findings of Fact

1. While Commission Staff and the parties began some preliminary work in 2003 towards the incentive plan review, other pressing Commission priorities have delayed its progress and completion.

2. The Commission's intent in adding the doubling mechanism to the performance incentive plan in the *271 Decision* was not to completely sever the connection between the harm imposed and the rigor of the performance incentive.

3. The Coalition does not refute SBC California's substantiation of the costly impact of the doubling mechanism, particularly on performance failures outside of the company's control.

4. It appears from the unrefuted data presented in SBC California's petition that JPSA changes do not always correct the burdens and flaws of the doubling mechanism.

5. In September 2003, a year after the issuance of the *271 Decision*, SBC California would not have had time to record and analyze sufficient months of data reflecting the impact of the doubling mechanism given the mechanism's January 2003 effective date.

6. By submitting its petition and joint declaration in March 2004, SBC California submitted a more comprehensive analysis of its performance results than it would have been able to if it had filed six months earlier in September 2003.

Conclusions of Law

1. The Commission does not have to wait until it has reexamined all the components of the performance incentive plan before it addresses the effects of the doubling mechanism.

2. The doubling mechanism, as currently structured, has imposed a significant financial impact on SBC California without a showing of related performance discrimination against, or competitive harm to any CLEC.

3. It is reasonable to modify D.02-09-050 by suspending the doubling mechanism in the performance incentive plan until the six-month review of the plan can be completed.

4. Until the review resumes and is completed, SBC California should continue to track and record the data for any continuing extended chronic failures so that Staff can closely monitor the company's performance to ensure that there is no backsliding.

5. The doubling mechanism should be reinstituted upon the Commission's own motion or that of the interested parties, if the recorded performance data tracking continuing extended chronic failures demonstrates backsliding.

6. This order should be effective immediately in order to halt the multiplying effect on SBC California of the doubling mechanism.

O R D E R

IT IS ORDERED that:

1. Decision (D.) 02-09-050 is modified so that the impact and effect of Ordering Paragraphs 10-14 (the doubling mechanism), an amended component of the performance incentive plan set forth in D.02-03-023, shall be suspended until the review of the performance incentive plan is completed and an order assessing the review is issued, or upon further order of the Commission.

2. During the time that the doubling mechanism is suspended, SBC California shall continue to track and record the data for any continuing extended chronic failures, and the Telecommunications Division Staff shall

closely monitor the company's performance to ensure that there is no backsliding.

3. If the performance data reveals discrimination by SBC California, or shows any competitive harm to the competitive local exchange carriers (CLECs), the doubling mechanism shall be reinstituted either upon the Commission's own motion or that of the interested parties.

4. Should the doubling mechanism be revived as a result of a showing of discrimination by SBC California, or of any competitive harm to the CLECs, SBC California may file an application with the Commission seeking reevaluation of the mechanism no sooner than 90 days after its reinstitution.

This order is effective today.

Dated _____, at San Francisco, California.